FILE COPY

Office - Supreme Court, U. S.
FILED
JAN 2 1941
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1940.

No. 495

JOSEPH T. RYERSON AND EDWARD L. RYERSON, JR., AS EXECUTORS OF THE ESTATE OF MARY M. RYERSON,
Petitioners,

vs.

THE UNITED STATES OF AMERICA,
Respondent.

BRIEF FOR PETITIONERS.

WALTER T. FISHER,
WILLIAM N. HADDAD,
Counsel for Petitioners,
135 South La Salle Street,
Chicago, Illinois.

THE GUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

INDEX.

Citations.

Cases:

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1940.

No. 495

OSEPH T. RYERSON AND EDWARD L. RYERSON, JR., AS EXECUTORS OF THE ESTATE OF MARY M. RYERSON,
Petitioners,

vs.

THE UNITED STATES OF AMERICA,
Respondent.

BRIEF FOR PETITIONERS.

Opinions Below.

The opinion of the Circuit Court of Appeals for the eventh Circuit (R. 90-97) is reported in *Ryerson* v. *United tates,* 114 F. (2d) 150. The opinions of the District Court R. 61-71) are reported in *Ryerson* v. *United States,* 28 F. upp. 265.

Jurisdictional Statement.

A petition for a writ of certiorari was filed on October , 1940, pursuant to Section 240(a) of the Judicial Code 43 Stat. 938, U. S. C. Tit. 28, sec. 347), and the writ was ranted on November 12, 1940.

Statement of Facts.

The Gift Tax Act of 1932 excluded from taxation the first $5,000 of gifts "made to any person by the donor during the calendar year".[1] In 1934 Mary M. Ryerson, the taxpayer in this case, transferred property to two trusts, one for the benefit of two persons, and the other for the benefit of three persons. The petitioners contend that $5,000 should be excluded from the taxable gifts on account of each of the beneficiaries of the trusts, making a total exemption of $25,000. The government's position, which has been upheld by the Circuit Court of Appeals, is that the number of $5,000 "exclusions" is determined by the number of trusts, and that the exemption is thus limited to $10,000.

The property transferred by the taxpayer consisted of two insurance policies on her own life, each in the face amount of $50,000 and with a cash surrender value of $40,286 (R. 72). One of these policies was assigned to Donald McKay Frost and Mary Ryerson Frost as trustees under a trust agreement dated October 31, 1933 (R. 71). The Commissioner of Internal Revenue allowed only one $5,000 exclusion on account of the assignment to this trust. The District Court determined that there were two beneficiaries of this trust, each receiving a present interest in the trust estate worth more than $5,000 (R. 65), and it accordingly allowed two exclusions (R. 74).

The other insurance policy was assigned to Joseph T. Ryerson and Edward L. Ryerson as trustees under a trust agreement dated November 15, 1934 (R. 72). The District Court found that there were three beneficiaries of this trust, each with a present interest in the trust estate worth more than $5,000 (R. 66, 72). The Commissioner originally refused to allow any exclusions on account of this assignment (R. 74), but the Government

1. Sec. 504(b)—quoted on p. 4.

conceded in its brief before the District Court that one exclusion should be allowed. The District Court held that three exclusions should be allowed (R. 74).

On appeal, the Circuit Court of Appeals reversed the District Court, and held that only one exclusion was allowable for each of the trusts in question (R. 96).

The Commissioner assessed, and the taxpayer paid, a tax upon the basis asserted by the Commissioner. The taxpayer duly filed claims for refund, which were rejected (R. 72-74), and thereafter brought suit in the District Court. The District Court decided this question in favor of the taxpayer. Another question—regarding the value of the insurance policies above mentioned and two other policies—was decided in favor of the government. Both parties appealed. Pending the appeals, the taxpayer died, and the present petitioners, as executors of her estate, were substituted as parties (R. 87). The Circuit Court of Appeals reversed the District Court on both issues, and both parties filed petitions for writs of certiorari, which were granted. The valuation question is presented in *United States* v. *Ryerson*, No. 494.

The tax due on account of the gifts made by the taxpayer during the year 1935 is also involved in the suit. There is no controversy regarding the amount of the gifts made in that year, but since the rate at which gifts are taxed for any year depends upon the total amount of gifts made in previous years, the controversy concerning the gifts made during 1934 affects the tax due for the year 1935.

Specification of Error to Be Urged.

The Circuit Court of Appeals erred in holding that under Section 504(b) of the Gift Tax Act of 1932 the plaintiff was entitled to only one $5,000 exclusion for each trust to which she transferred property, rather than one exclusion for each beneficiary of the trusts.

transfer to a trust under which the donor retains the power to change the beneficiaries. *Rasquin* v. *Humphreys*, 308 U. S. 54. On the other hand, the relinquishment of the power to revoke or to change the beneficiaries—thus fixing the beneficial interests—does constitute a taxable gift. *Estate of Sanford* v. *Commissioner*, 308 U. S. 39. It is thus shown that the statute is concerned with the transfer of the equitable ownership, or the economic benefits, of the property, rather than its legal title. In the simple case of a transfer, by way of gift, to A as trustee for B, the transfer is taxable either because the conveyance to A operates to transfer the equitable title to B, or because the transfer results in an "indirect" gift to B within the meaning of the statute. In either case the "person" to whom the taxable gift is made is the beneficiary, and under any fair construction of the statute, the allowable exemption should be measured by the gift to that person. It is true that there is also a transfer of the legal title to A, the trustee. But the legal title, by itself, is of no value, and its transfer would not give rise to a tax. A transfer, for example, to trustees for the benefit of the donor himself would obviously not be taxable. (See *Burnet* v. *Guggenheim*, *supra*, p. 287.) In the *Rasquin* case the legal title was transferred to the trustees, and irrevocably so; but there was no tax, because the donor retained control over the beneficial interests.

In the *Sanford* case the trust was created in 1913 and was made irrevocable in 1919, but the power to change the beneficiaries was not relinquished until 1924. If the trust was the "person" to whom the gift was made within the meaning of section 504 (b), then the $5,000 exemption would be applicable against the gift made in 1913, or, at the latest, 1919, because there was no further transfer to the *trust* after that date. But since the 1913 and 1919 transactions were not taxable, an exemption in either of those years would be meaningless. And on the same reasoning,

no exemption would be allowed in 1924, in the only year in which a taxable transfer occurred.[2]

A donor can make a gift by executing a declaration of trust naming himself as trustee.[3] In such a case there would be no conveyance of the legal title. The only transfer that would occur would be a transfer of the equitable title to the beneficiaries; and in that case it would be difficult to deny that the beneficiaries are the "persons" to whom the gift was made. Yet, surely, the exemption is not to be any different under a declaration of trust from what it is under a deed of trust. Or, to vary the example slightly, a donor might set up a trust naming himself as the beneficiary, and later assign his beneficial interest to his children. Here again, it is obvious that the only donees are the children, and that the $5,000 exclusions must be deducted from the values of the equitable interests assigned to them. Yet the case would be no different, in substance, if the children had been named as the original beneficiaries.

The position taken by the government rests largely on the definition of the word "person" which is contained in section 1111 (a).[4] It should be noted that the definitions in this section have no special reference to the Gift Tax Title. The terms defined are those used generally throughout the Revenue Act, and the definitions were carried over from previous revenue acts that contained no gift tax provisions at all.[5] It should not be assumed that the general definitions were intended to deprive the words used of their ordinary meanings when to do so would produce illogical or arbitrary results. But taken in the most favorable light,

2. The 1924 Act under which the *Sanford* case arose contained no provision similar to section 504(b) of the 1932 Act. But the same situation could easily arise under the later Act.

3. The Commissioner's Regulations expressly so provide. Reg. 79, Art. 2.

4. Quoted on p. 5.

5. Section 1111(a)(1) of the Revenue Act of 1932 is the same as section 701(a)(1) of the Revenue Act of 1928, and section 2(a)(1) of the Revenue Acts of 1924 and 1926.

the definition in question does not support the government's argument. It is true that a trust is a "person" under section 1111 (a), but so also is an individual; and since it is the transfer to the beneficiary that gives rise to the tax, the beneficiary, and not the trust, is the person that should be considered as the donee. This is certainly so if the same principles are applied in construing the exemption provisions of the Act as are applied to its taxing provisions. In this respect, a gift to a trust is no different from a gift which a donor might make by depositing money in a bank to the credit of his children. In such a case, the bank that receives the money, being a corporation, is a "person" within the meaning of section 1111 (a), just as much as a trust would be a "person". But it does not follow that in the application of section 504 (b) the bank should be considered as *the* person to whom the gift is made, and that the gifts to the real donees who, of course, are also "persons", should be disregarded.

The parenthetical clause in section 504 (b) gives support to our contention. That clause limits the $5,000 exemptions to gifts "other than of future interests in property". Congress must have been aware that most future interests these days are created by means of trusts, and that legal future interests are comparatively rare. It is fair to assume that in denying the exemption with respect to gifts of future interests, Congress had in mind that the donees of transfers in trust were the beneficiaries, and that the $5,000 exclusions would be applicable to their interests. Otherwise the limitation placed on the exemption provision would have little practical significance.

The denial of the exemption in the case of future interests is explained in the Congressional Committee Reports on the Revenue Act of 1932 as follows:

> "The term 'future interests in property' refers to any interest or estate, whether vested or contingent,

> limited to commence in possession or enjoyment at a future date. The exemption being available only in so far as the donees are ascertainable, the denial of the exemption in the case of gifts of future interests is dictated by the apprehended difficulty, in many instances, of determining the number of eventual donees and the values of their respective gifts.'"[6]

It is evident from this that the exemption was intended to apply to the interests of the beneficiaries; otherwise the "apprehended difficulty * * * of determining the number of eventual donees and the values of their respective gifts" would not arise. The Committee Reports go further and give specific examples of gifts that would be taxable under the proposed act, including the following:

> "(7) where A creates a revocable trust naming B as beneficiary, *a gift to B* of the corpus is effected when A relinquishes the power to revoke or the power is otherwise terminated in B's favor." (Italics supplied.)[7]

In another example, it is stated that a transfer by A to a corporation owned by his children would constitute a gift to the children.[8]

The above view is also borne out by the Commissioner's regulations under the 1932 Act. Article 11 of Regulations 79 (original edition) gives the following illustration of how the $5,000 exclusions are computed:

> "A resident donor gives $10,000 in cash to each of his two sons and conveys, without a valuable consideration, property of the value of $100,000 to a trustee who is to pay the income to the donor's wife during her lifetime and at her death deliver the property to his two daughters. There should be subtracted $5,000 from each of the $10,000 gifts to the sons, *and $5,000 from the value of the life estate given to the wife*, assuming that the value of her estate equals or exceeds

6. H. Rep. No. 708, p. 29; S. Rep. No. 665, p. 41, 72d Cong. 1st Sess.; Int. Rev. Bull., 1939-1 C. B. (Part 2), pp. 457, 478, 496, 526.

7. Int. Rev. Bull., 1939-1 C. B. (Part 2), pp. 477, 525.

8. Ibid.

> that amount. *The interests of the daughters in the trust property being future interests, no such subtraction is to be made therefrom * * *.*" (Italics supplied.)

It will be noted that in the above example, $5,000 is deducted from the value of the life estate given to the wife, while the remainder interests of the daughters, "being future interests", are taxed in full. The inference is clear that if the daughters had received present interests, two additional deductions of $5,000 would have been allowable, making a total of one exemption for each beneficiary of the trust.

The view that the exemptions allowable are determined by the number of trusts originated with the case of *Wells* v. *Commissioner*, 34 B. T. A. 315, 88 F. (2d) 339 (C. C. A. 7th). That case involved three separate trusts, each for the benefit of a different person. The Commissioner contended that no exemptions were allowable, on the ground that under the terms of the trust agreements the interests of the beneficiaries were "future interests". The Board of Tax Appeals overruled the Commissioner, holding that the beneficiaries took present interests, and that, at any rate, since the entire title was conveyed to the trusts, and the trusts were "persons", a $5,000 exclusion should be allowed on account of each trust. The Board's decision was affirmed by the Circuit Court of Appeals for the Seventh Circuit, that court expressing the opinion that the trusts could be considered as donees for the purposes of the exemption.

In the *Wells* case there were three trusts and three beneficiaries; so it did not make any difference in the result whether the exemptions were related to the trusts or to the beneficiaries. But in consequence of the *Wells* case, the Board of Tax Appeals, for a time, followed the rule of allowing as many $5,000 exemptions as there were trusts, regardless of whether there were several benefi-

ciaries of one trust or several trusts for one beneficiary.[9] This construction of the statute made it possible for a donor to increase the $5,000 exemption to any desired amount by the simple expedient of creating a number of trusts for the same donee. When these decisions came to the attention of Congress in 1938, Congress expressed its disapproval by amending the statute so as to withhold the exemption from gifts in trust as well as those of future interests.[10] The reason for the amendment is set forth in the Senate Finance Committee Report on the Revenue Act of 1938 as follows:

> "* * * The statute, as thus construed, affords ready means of tax avoidance, since a donor may create any number of trusts in the same year in favor of the same beneficiary with a $5,000 exclusion applying to each trust, whereas the gifts, if made otherwise than in trust, would in no case be subject to more than a single exclusion of $5,000."[11]

As observed by the Circuit Court in *McBrier* v. *Commissioner,* 108 F. (2d) 967, 969 (C. C. A. 3d), the 1938 amendment goes farther than was necessary to close the loophole created by the Board decisions. But the fact remains that if it had not been for those decisions, there would have been no occasion for making an arbitrary distinction between gifts in trust and those not in trust.

---

9. See *Knox* v. *Commissioner,* 36 B. T. A. 630; *Rheinstrom* v. *Commissioner,* 37 B. T. A. 308; *Cox* v. *Commissioner,* 38 B. T. A. 865; *Hutchings* v. *Commissioner,* 40 B. T. A. 27.

10. Sec. 505, Rev. Act of 1938 (52 Stat. 565).

11. S. Rep. No. 1567, 75th Cong., 3d Sess., p. 41; Int. Rev. Bull. 1939-1 C. B. (Part 2), pp. 779, 809. The omitted portion of the paragraph quoted refers to decisions of the Board of Tax Appeals and of "several of the Federal Courts," as so construing the statute. Other than the *Wells* case, *supra,* we have found only one court decision adopting this construction, viz., the District Court decision in *Robertson* v. *Nee* (D. C. Mo. W. D. June 2, 1938), which has been reversed in *Robertson* v. *Nee,* 105 F. (2d) 651 (C. C. A. 8th). The dictum in *Commissioner* v. *Krebs,* 90 F. (2d) 880 (C. C. A. 3d), following the *Wells* case, was later disapproved by the same court. *McBrier* v. *Commissioner,* 108 F. (2d) 967 (C. C. A. 3d).

Three of the Board decisions on this question were appealed in the Third, Fifth and Eighth Circuits, and were reversed, the Circuit Courts holding that the number of exclusions was determined by the number of beneficiaries:

McBrier v. *Commissioner*, 108 F. (2d) 967 (C. C. A. 3d).

Hutchings v. *Commissioner*, 111 F. (2d) 229 (C. C. A. 5th).

Rheinstrom v. *Commissioner*, 105 F. (2d) 642 (C. C. A. 8th).

Similar conclusions were reached by the Circuit Courts in the First and Fourth Circuits, and by the Court of Claims:

Welch v. *Davidson*, 102 F. (2d) 100 (C. C. A. 1st).

Early v. *Reid*, ... F. (2d) .... (C. C. A. 4th, Aug. 7, 1940).

Pelzer v. *United States*, 31 F. Supp. 770 (Ct. Cls.).

And on January 30, 1940, the Board of Tax Appeals overruled its earlier decisions and reached the same conclusion. *Rubinstein* v. *Commissioner*, 41 B. T. A. 220. The present case now stands alone in its ruling on this question. In reaching this decision, the Circuit Court evidently felt bound by its previous decision in the *Wells* case (88 F. (2d) 339), although, as above pointed out, this issue was not squarely presented in that case.

The decision of the lower court creates a needless and artificial distinction: If a man gives a house to his two children he gets an exemption of $10,000; but if he conveys the house to a trustee for the use of the children, his exemption is only $5,000—although he could easily increase it to $10,000 or $50,000 by creating several trusts and conveying an undivided interest to each trust. The "change of economic benefits" which this court has recognized as being "of the essence of a transfer" has been disregarded, and the amount of the tax has been made to depend on the form of the transfer and the "technicalities

of title." We submit that the decision of the Circuit Court cannot be reconciled with the words of the statute or with the principles underlying the decisions of thi[illegible]rt in the *Guggenheim*, *Sanford*, and *Ras*[illegible], and that it should therefore be reversed.

Respectfully submitted,

WALTER T. FISHER,
WILLIAM N. HADDAD,
Counsel for Petitioners.

December, 1940.